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SUBJECT: INDONESIA'S LEGISLATURE PASSES NEW MINING LAW

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¶1. Summary. On December 16, Indonesia's legislature (DPR) passed a new mining law that will promote domestic small and medium sized investments at the expense of large international mining companies. Bowing to opposition from the Ministry of Energy and Mineral Resources, the DPR agreed that the law will not force existing mining contracts of work (COW) to convert to mining licenses, although provisions remain that erode the sanctity of current contracts. Industry reaction to the new bill has been almost universally negative, with trade groups predicting that uncertainty will increase, causing foreign investment to decrease. The law also seeks to build local government capacity to oversee mining operations. End Summary.

NO MORE CONTRACTS OF WORK

¶2. Policymakers have sought to revise Indonesia's 1967 Mining Law for some time, to reflect the new, decentralized governing structure. In earlier versions of the new bill, legislators sought to eliminate existing contracts of work (COW) and replace them with mining licenses. A COW defines a mining company's rights and obligations in all aspects of a mining operation - tax and fee obligations, royalties, concession size and duration, land use, construction of facilities, divestiture requirements, etc. - and it remains independent of Indonesia's overall tax and corporate laws for the duration of the COW. In the system of mining licenses created in the new law, licenses give the right to mine in a defined area but leave the mining company subject to all changes in Indonesia's mining, tax, and corporate laws. Legislators were unhappy with the prospect of a two-tier COW/licensing system for the duration of current COWs, many of which will remain valid for decades.

¶3. The Ministry of Energy and Mineral Resources resisted the DPR's plans to convert COWs, and the President threatened to veto earlier versions of the proposed bill over this issue. In the end, the DPR gave in and grandfathered existing COWs. Nevertheless the legislation mandates undefined changes to "non-state-revenue" COW provisions to comply with the new law.

NEGATIVE BUSINESS REACTION

¶4. Business reaction to the new law has been negative. Priyo Pribadi Soemarno, Executive Director of the Indonesian Mining

Association (IMA), a business group that includes foreign and domestic mining companies, believes that it will further erode Indonesia's mining investment climate. The new risks and limitations for mining companies that the law creates include:

-- Government can cancel mining licenses, with little recourse from an affected company.
-- Companies will be subject to all changes in royalties, taxes, fees, and corporate ownership. Soemarno highlighted the fact that all levels of Indonesian government have reputations for frequently imposing new financial obligations on resource extraction companies.
-- Foreign mining companies must begin a divestment program within 5 years of production, even though Indonesia's investment laws allow foreign companies to own 100% of a mining operation. Divestment problems have caused major challenges for a number of foreign mining companies in Indonesia, most recently Newmont.
-- Concession areas are smaller than in the past, which works against the business plans of large companies such as Freeport, Newmont, and Rio Tinto.
-- Companies can no longer export unprocessed ore, but must smelt it in-country. Legislators hope this provision will spur new value-added industries, but industry analysts fear that this requirement may give local smelters monopoly-pricing powers.
-- Mining companies are barred from hiring subsidiaries and affiliates for mining operations. Companies must give preference to local and national companies when subcontracting, although local subsidiaries of international companies qualify as national companies.

THERE IS AN UPSIDE

¶5. The law addresses local governments' lack of institutional capacity to manage licenses. Provincial and regency governments have had the authority to issue mining licenses to domestic companies for several years, but previously there was no attempt to train these levels of government in contracting, management, or oversight of mines. The new law obligates central government ministries to train local governments on a range of mining oversight issues, including safety, research, and environmental issues. The law also states that central government ministries retain the primary authority to inspect mining operations, although they can delegate this right to local governments at their discretion.

KEY PROVISIONS OF THE NEW LAW

¶6. Types of Licenses
-- Mining Permit (IUP): Awarded by central or local governments (governor, mayor, or regent) through tender.
-- Special Mining Permit (IUPK): Awarded only by the central government through tender for mining regions designated as State Reserve Areas. Only for coal, copper, lead, gold, iron, nickel, and bauxite.
-- People's Mining Permit (IPR): Awarded by a mayor or regent, only for small-scale mining (currently unlicensed and considered illegal).

¶7. License Duration
-- IUP and IUPK: Exploration licenses are for 7 or 8 years. Production licenses are for 20 years for coal and metal, 10 years for precious stones, all with the option of two 10-year extensions.
-- IPR: Production license is valid for 5 years, but extendable.

¶8. Concession Size
-- IUP and IUPK: Exploration concessions of 100,000 hectares (ha) for metal, 50,000 ha for coal. Production concessions capped at 25,000 ha for metal, 15,000 ha for coal.
-- IPR: Individual license - 1 ha; group license - 5 ha; cooperative - 10 ha.

¶9. Foreign Ownership: Foreign companies are allowed to own 100% of mining operations under Indonesia's investment law, but must begin an undefined divestment process within five years of production under the new mining law.

¶10. Royalties: All license holders must pay royalties, to be defined by regulation. IUPK holders must additionally pay 10% of their production to the government - 4% central government, 1% provincial, 2.5% regency of production, 2.5% other regencies in the province.

¶11. In-Country Processing: IUP and IUPK holders must refine their product inside Indonesia, whether by establishing their own smelters or using others. COW holders have 5 years to comply with this requirement.

¶12. Subcontracting: License-holders cannot subcontract to subsidiaries, and they must give preference to local or national mining service companies in their operations.

¶13. Production Controls: The central government may set provincial production limits for certain commodities and mandate domestic market obligations.

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